IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

ITR No.162 of 1999
Date of decision:6.12.1999

The Commissioner of Income Tax (Central) Ludhiana

....Petitioner

versus

Hero Cycles (P) limited, Ludhiana.

....Respondent

CORAM: HON'BLE MR. JUSTICE ADARSH KUMAR GOEL
HON'BLE MR. JUSTICE RAJESH BINDAL

Present: Mr. SK Garg Narwana, Advocate, for the revenue.
Mr. Akshay Bhan, Advocate, for the assessee.

JUDGMENT:

Following question of law has been referred for the opinion of this Court by the Income Tax Appellate Tribunal, Chandigarh Bench, Chandigarh (for short, 'the Tribunal'), arising out of its order dated 12.5.1998 in ITA No.1056/Chandi/1992, for the assessment year 1988-89:-

> "Whether on the facts and in the circumstances of the case, the ITAT was right in law in deleting disallowance of interest of Rs.16,02,423/- on the ground that there is no nexus between the borrowings and interest-free advance made to certain parties?"

The Assessing Officer disallowed claim for interest of the assessee and made an addition to the income shown by the assessee. It was observed that advances were made by the assessee to persons closely connected with it or its directors. It was noted that the assessee was paying 18% interest to the bank apart from bank charges and was charging only 10% interest from some of the persons and was not charging any interest from some others. It was concluded that interest paid to the bank was not for the purpose of business. The CIT(A) held that nexus of amount advanced was proved to some extent and disallowance was, thus, restricted only to

that extent. The Tribunal upheld the view taken by the CIT(A). The Tribunal observed in para 4.4 of its order as under:-

> "We have carefully considered the submissions made by both the parties and have perused orders of the tax authorities and other relevant papers placed in the form of paperbook, to which our attention was invited during the course of hearing. We have also seen the case law relied upon by both the parties. It is observed that CIT(A) has given specific finding after examining each loan advanced by the assessee and after threadbare discussion, that only in the case of M/s. Majestic Auto Limited, disallowance of Rs.36,587/- was to be made. It is also observed that the case law relied upon ld. D.R. is of no help to the department as it is based on finding of fact. Ld. D.R. has not been able to dialodge the findings recorded by CIT(A) and he has only relied on order of AO. On facts and circumstances of the case, we, therefore, decline to interfere with order of CIT(A) insofar as it pertains to relief allowed to the assessee. With reference to disallowance made in the case of M/s. Majestic Auto Limited to the extent of Rs.36,587/-, we have perused details placed at page 115 of the paperbook, whereby Ld counsel has tried to make out a case that if at all disallowance of only Rs.14,414/- was required. It is observed that whereas the date mentioned by CIT(A) in her order at page 14 with reference to advance of Rs.28 lakhs is 25.2.1987 and opening balance on that date has been mentioned as credit of Rs.37.63 lakhs, the amount of advance mentioned in calculation-sheet placed at page 115 is Rs.20 lakhs as on 25.5.1987 when there was a debit balance of Rs.3,96,203/-, which ultimately was converted into credit balance on 4.6.1987 at Rs.8,54,653/-, where on the assessee has calculated interest at 16% for ten days amounting to Rs.1,737/-. We feel that it will be just and fair to restore the issue of addition of Rs.36,587/- to the file of AO for verification of the factual position only in this respect, after allowing the assessee a reasonable opportunity of being heard. In case the position mentioned is found to be correct, AO may allow appropriate relief to the assessee, otherwise disallowance of Rs.36,587/- would stand."

The issue has been gone into by this Court in **Commissioner of Income Tax-I, Ludhiana v. M/s Abhishek Industries Limited, Ludhiana**, ITA No.110 of 2005, decided on 4.8.2006. After reviewing case law on the point, it was held that interest on the loan raised to the extent the amount is advanced to sister concern for non-business purposes could not be

allowed as a deduction to the assessee. Relevant observations in the said judgment are as under:-

> "As far as the issue of establishment of nexus of the funds borrowed vis-a-vis the funds diverted towards sister concern on interest free basis is concerned, in our view, the stand of the assessee that the onus of proving the nexus of funds available with the assessee with the funds advanced to the sister concerns without interest is on the Revenue is not correct. Section 36(1)(iii) of the Act provides for deductions of interest on the loans raised for business purposes. Once the assessee claims any such deduction in the books of accounts, the onus will be on the assessee to satisfy the Assessing Officer that whatever loans were raised by the assessee, the same were used for business purposes. If in the process of examination of genuineness of such a deduction, it transpires that the assessee had advanced certain funds to sister concerns or any other person without any interest, there would be very heavy onus on the assessee to be discharged before the Assessing Officer to the effect that inspite of pending term loans and working capital loans on which the assessee is incurring liability to pay interest, still there was justification to advance loans to sister concerns for non-business purposes without any interest and accordingly, the assessee should be allowed deduction of interest being paid on the loans raised by it to that extent. In our view, even the plea of nexus of loans raised by the assessee with the funds advanced to the sister concerns on interest free basis, may be it is pleaded to be out of sale proceeds or share capital or different account cannot be accepted.
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> Entire money in a business entity comes in a common kitty. The monies received as share capital, as term loan, as working capital loan, as sale proceeds etc. do not have any different colour. Whatever are the receipts in the business, that have the colour of business receipts and have no separate identification. Sources has no concern whatsoever. The only thing sufficient to disallow the interest paid on the borrowing to the extent the amount is lent to sister concern without carrying any interest for non-business purposes would be that the assessee has some loans or other interest bearing debts to be repaid. In case the assessee had some surplus amount which, according to it, could not be repaid prematurely to any financial institution, still the same is either required to be circulated and utilised for the purpose of business or to be invested in a manner in which it generates income and not that it is diverted towards sister concern free of interest. This would result in not presenting true and

> correct picture of the accounts of the assessee as at the cost being incurred by the assessee, the sister concern would be enjoying the benefits thereof. It cannot possibly be held that the funds to the extent diverted to sister concerns or other persons free of interest were required by the assessee for the purpose of its business and loans to that extent were required to be raised. We do not subscribe to the theory of direct nexus of the funds between borrowings of the funds and diversion thereof for non-business purposes. Rather, there should be nexus of use of borrowed funds for the purpose of business to claim deduction under Section 36(1)(iii) of the Act. That being the position, there is no escape from the finding that interest being paid by the assessee to the extent the amounts are diverted to sister concern on interest free basis are to be disallowed.
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> If the plea of the assessee is accepted that the interest free advances made to the sister concerns for non-business purposes was out of its own funds in the form of capital introduced in business, that again will show a camouflage by the assessee as at the time of raising of loan, the assessee will show the figures of capital introduced by it as a margin for loans being raised and after the loans are raised, when substantial amount is diverted to sister concerns for non-business purposes without interest, a plea is sought to be raised that the amount advanced was out of its capital, which in fact stood exhausted in setting up of the unit. Such a plea may be acceptable at a stage when no loans had been raised by the assessee at the time of disbursement of funds. This would depend on facts of each case.
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> Section 106 of the Indian Evidence Act or the principles analogous thereto places the burden in respect thereof upon the assessee, as the facts are within its special knowledge. However, a presumption may be raised in a given case as to why an assessee who for the purpose of running its business is required to borrow money from banks and other financial institutions would be giving loan to its subsidiary companies and that too when it pays a heavy interest to its lenders, it would claim no or little interest from its subsidiaries."

In the present case, what was disallowed was only the difference of interest payable by the assessee to the bank and the interest charged from the sister concerns or associates. The plea of funds having been advanced from accounts containing credit balance or business receipts has already been rejected in the judgment of this Court in **Abhishek**

Industries' case (supra).

In view of the above, the question referred is answered in favour of the revenue and against the assessee.

The reference is disposed of accordingly.

(Adarsh Kumar Goel)
Judge

December 6, 2006
'gs'

(Rajesh Bindal)
Judge